

Message Text

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60

ACTION EUR-25

INFO OCT-01 ISO-00 CEA-02 CIAE-00 COME-00 EB-11 FRB-02

INR-10 NSAE-00 RSC-01 CIEP-02 SPC-03 STR-08 TRSE-00

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FM USMISSION EC BRUSSELS

TO SECSTATE WASHDC 6097

INFO AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY COPENHAGEN

AMEMBASSY DUBLIN

AMEMBASSY LUXEMBOURG

AMEMBASSY LONDON

AMEMBASSY PARIS

AMEMBASSY ROME

AMEMBASSY THE HAGUE

USMISSION GENEVA

USMISSION OECD PARIS

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PASS TREASURY, CEA, FRB AND COMMERCE

E.O. 11652: N/A

TAGS: EFIN, EEC

SUBJECT: EC COMMISSION POSITION ON

FISCAL HARMONIZATION

1. SUMMARY. THE EC COMMISSION HAS ENUNCIATED A NEW POSITION IN PRINCIPLE ON TAXATION OF INTEREST ON SECURITIES AND DIVIDENDS FROM STOCKS. WHEREAS THE COMMISSION HAD PREVIOUSLY OPPOSED WITHHOLDING TAXES ON BOND INTEREST, IT HAS NOW COME OUT IN FAVOR OF A GENERALIZED, HIGH-LEVEL WITHHOLDING TAX.

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PENDING ESTABLISHMENT OF A COMMUNITY-WIDE SYSTEM OF CONTROLS

ON CAPITAL MOVEMENTS, AS CALLED FOR IN COMMISSION PROPOSALS ON ECONOMIC AND MONETARY UNION, THE COMMISSION DOES NOT INTEND TO MAKE ANY FORMAL PROPOSALS ON WITHHOLDING. ON TAXATION OF DIVIDENDS, THE COMMISSION HAS DECIDED TO PRESS FOR AN IMPUTATION SYSTEM UNDER WHICH A STOCKHOLDER IS GRANTED A TAX CREDIT OF SOME FRACTION OF THE TAX OWED BY THE CORPORATION PAYING THE DIVIDEND. THE COMMISSION INTENDS TO COMMUNICATE ITS VIEWS FORMALLY TO THE COUNCIL IN THE NEAR FUTURE. ALTHOUGH NO EARLY ACTION BY THE COUNCIL IS EXPECTED, THE COMMISSION'S IDEAS MERIT CONTINUED ATTENTION INsofar AS THEY MIGHT AFFECT THE BORROWING AND LENDING PRACTICES AND TAX OBLIGATIONS OF U.S. BUSINESS INTERESTS IN THE COMMUNITY. END SUMMARY.

2. THE COMMISSION HAS MADE KNOWN ITS CURRENT POSITION ON TWO ASPECTS OF FISCAL HARMONIZATION WITHIN THE COMMUNITY. THE COMMISSION POSITION, WHICH HAS NOT BEEN EXPRESSED IN ANY FORMAL COMMUNICATION, COVERS WITHHOLDING TAX ON INTEREST ON BONDS AND TAX CREDITS ON DIVIDENDS. WITH RESPECT TO BOND INTEREST, THE COMMISSION HAS UP UNTIL NOW FAVORED THE SUPPRESSION OF WITHHOLDING TAXES IN THE HOPE OF STRENGTHENING THE EC CAPITAL MARKET AND LOWERING THE COST OF FINANCING BUSINESS AND INVESTMENT. IN COMING OUT IN FAVOR IN PRINCIPLE OF TAX WITHHOLDING AT THE SOURCE, THE COMMISSION IS GIVING PRIORITY TO THE STRUGGLE AGAINST TAX FRAUD AND FOR A MORE EQUITABLE FISCAL SYSTEM. THE COMMISSION ADVOCATES A HIGH LEVEL OF WITHHOLDING, WE UNDERSTAND PROBABLY 25 PERCENT, BUT DOES NOT INTEND TO MAKE ANY SPECIFIC PROPOSALS TO THIS EFFECT IN THE NEAR FUTURE. RATHER, IT INTENDS TO WAIT UNTIL SUCH TIME AS THE COUNCIL MAY TAKE ACTION ON COMMUNITY-WIDE MEASURES TO CONTROL CAPITAL MOVEMENTS WHICH WOULD DISCOURAGE THE LIGHT OF CAPITAL OUTSIDE THE COMMUNITY THAT MIGHT RESULT FROM GENERALIZED APPLICATION AT THIS TIME OF A HIGH WITHHOLDING TAX ON BOND INTEREST. FOR THE MOMENT, THEREFORE, MEMBER STATES WILL CONTINUE TO APPLY WHATEVER SYSTEM THEY WISH AND THE COMMISSION WILL LIMIT ITSELF TO A STUDY OF TECHNIQUEST DESIGNED TO

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AVOID DISCRIMINATION AND DOUBLE TAXATION. (IT SHOULD BE NOTED, HOWEVER, THAT THE COMMISSION'S LATEST PROPOSALS ON ECONOMIC AND MONETARY UNION CALL FOR THE COUNCIL TO DECIDE BY THE END OF 1974 ON A SYSTEM OF EXTERNAL CAPITAL CONTROLS AND ON HARMONIZATION OF TAX WITHHOLDING SYSTEMS FOR INTEREST AND DIVIDENDS.)

3. WITH RESPECT TO DIVIDENDS ON STOCKS, THE COM-

MISSION HAS REJECTED THE "CLASSICAL" SYSTEM IN WHICH PROFITS ARE TAXED BOTH AT THE CORPORATE AND INDIVIDUAL LEVEL THROUGH DIVIDENDS. INSTEAD, IT HAS OPTED FOR THE IMPUTATION SYSTEM CURRENTLY PRACTICED IN FRANCE AND THE UK. UNDER THIS SYSTEM, A PERCENTAGE OF THE PROFITS TAX PAID BY CORPORATIONS CAN BE DEDUCTED BY STOCKHOLDERS AS A CREDIT AGAINST THEIR TAX LIABILITY. THE COMMISSION BELIEVES THIS SYSTEM WILL RESOLVE THE PROBLEM OF DOUBLE TAXATION INTERNALLY AND WILL ALSO BE MORE NEUTRAL WITH RESPECT TO DIFFERENT FORMS OF FINANCING AND PROVIDE A GREATER INCENTIVE TO SMALL INVESTORS TO INVEST IN EQUITY MARKETS. IT IS ALSO HOPED THIS SYSTEM WILL DISCOURAGE TAX EVASION BY RESORT TO GIMMICKS SUCH AS FICTITIOUS HOLDING COMPANIES. AT THE SAME TIME, THE COMMISSION RECOGNIZES THAT THE SYSTEM WILL BE MORE COMPLICATED INTERNATIONALLY WITH RESPECT TO THE PROBLEM OF DOUBLE TAXATION. IT THEREFORE EXPECTS TO EXPLORE SUCH TECHNICAL PROBLEMS WITH THE MEMBER STATES. WE UNDERSTAND THE COMMISSION WILL NOT PROPOSE A FORMAL DIRECTIVE ON THE IMPUTATION TAX BUT RATHER SEND A LETTER TO THE COUNCIL IN THE NEAR FUTURE SETTING FORTH THE COMMISSION'S POSITION.

4. COMMENT. WE BELIEVE THE COMMISSION'S PLANS IN THE AREA OF FISCAL HARMONIZATION MERIT CAREFUL AND CONTINUED STUDY WITH RESPECT TO THEIR IMPLICATIONS FOR U.S. BUSINESS INTERESTS OVERSEAS. WHILE WE ARE NOT IN A POSITION TO DRAW ANY CONCLUSIONS AT THIS TIME -- PARTICULARLY IN THE ABSENCE OF FORMAL PROPOSALS -- ONE LOCAL U.S. ATTORNEY HAS SUGGESTED THAT A HIGH RATE OF WITHHOLDING ON BOND INTEREST WOULD AFFECT THE TYPE OF LENDING CHOSEN BY U.S. FIRMS AND SUBSIDIARIES.

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IT MIGHT ALSO CHANGE THE CURRENT SYSTEM OF CORPORATE HOLDINGS, WHICH ARE BASED ON THE CURRENT WITHHOLDING PRACTICES OF MEMBER STATES. ALSO AFFECTED WOULD BE THE GROSS THOUGH NOT NECESSARILY NET FOREIGN TAX BURDEN OF U.S. CORPORATE ENTITIES. (IF THE GROSS FOREIGN TAX IS STILL LESS THAN THE U.S. CORPORATE TAX AGAINST WHICH THE FOREIGN TAX CAN BE CREDITED, THE NET FOREIGN TAX BURDEN MIGHT REMAIN UNCHANGED.)

5. IN THE EVENT OF A COMMUNITY-WIDE IMPUTATION TAX SYSTEM ON DIVIDENDS, EUROPEAN COMPANIES WOULD PRESUMABLY BENEFIT FROM ADVANTAGES CURRENTLY ENJOYED IN PRACTICE BY U.S. FIRMS THAT ARE ELIGIBLE FOR TAX CREDITS ON TAXES PAID BY THEIR SUBSIDIARIES ABROAD.

END COMMENT.GREENWALD

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